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Supreme Court of the United States

OCTOBER TERM, 1940

No. 685

WILLIAM H. KNIFFIN, as trustee in bankruptcy of C. H. EARLE, INC., bankrupt,

Petitioner,

—against—

STATE OF NEW YORK,

Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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Of Counsel.

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Petitioner,

—against—

STATE OF NEW YORK,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, William H. Kniffin, as trustee in bankruptcy of C. H. Earle, Inc., bankrupt, respectfully shows:

A.

Summary Statement of the Matter Involved.

This is an application for a writ of certiorari to review the judgment entered in the Court of Claims of the State of New York on the 26th day of August, 1940 (p. 82) on the remittitur of the Court of Appeals of said State (p. 81), for $21,804.03 in favor of the petitioner against the respondent. The petitioner believes that there should have been awarded to him an additional $32,506.73 with interest thereon.

The petitioner originally filed his claim consisting of sixteen items, in said Court of Claims (p. 3). After trial in that Court, petitioner was granted judgment for $1,192.50 with interest, aggregating $1,583.64, on four items (none of which is here involved) (p. 25). On petitioner's appeal to

the Appellate Division, Third Department, said Court unanimously modified the judgment, granted the petitioner recovery on three more items (similarly not here involved) and increased the judgment to $18,118.44. Hill, *P. J.*, wrote for the unanimous Court, 257 A. D. 43, 12 N. Y. Supp. (2nd) 422 (p. 70).

The petitioner further appealed to the Court of Appeals of the State of New York on item #12 alone (f. 187), requesting an additional $32,506.73, composed of $30,703.68, principal, and $1,803.05, interest. That Court further modified the judgment by awarding to petitioner the interest item of $1,803.05. Sears, *J.*, wrote an opinion, 283 N. Y. 317 (p. 76), for the unanimous Court. Only the principal of $30,703.68 is here involved.

The facts (*) on which this controversy is based are, as follows: On August 3rd, 1928, C. H. Earle, Inc. (hereinafter referred to as Earle) made a contract with the State of New York to construct a section of the public highway known as Jones Beach Causeway at a cost of over one million dollars. Earle performed the contract through various sub-contractors among which was Raymond Concrete Pile Company (hereinafter referred to as Raymond). On May 17th, 1929, Earle gave to Raymond a written assignment of moneys due or to become due from the State pursuant to the contract, to the extent of $102,462.36, payable in three instalments as follows:

(1) $41,055 out of the *next* payment after the date of the assignment made or to become due to Earle on account of said contract; but if said payment would be insufficient to pay the Raymond instalment, the deficit was to be paid out of the next succeeding payment due to Earle;

(2) $30,703.68 (plus any deficit remaining from the first instalment) out of the *second* payment due to Earle after

---

* (To reduce a Record of over 800 pages in the Appellate Division, both counsel joined in an Agreed Statement of Facts In Lieu of Testimony for the Court of Appeals, pp. 45 et seq., and also printed only claimant's Exhibits 15 and 16, pp. 50, et seq. and p. 59.)

the date of the assignment, but if the said two payments due to Earle on the contract would not amount to $71,758.68 (the total of Raymond's first two instalments), the deficit was to be paid out of the next succeeding payment due to Earle;

(3) $40,703.68 (plus any deficit due from the first two instalments) out of the *third* payment to Earle after the date of the assignment.

The assignment was properly filed and docketed in the required State offices on May 20th, 1929. Nevertheless, in disregard of the Raymond assignment, the State paid to Earle (and not to Raymond) the next three instalments, as follows:

Estimate	Date	Amount
#7	May 21st, 1929	$41,055.00
#8	June 7th, 1929	69,406.56
#9	June 17th, 1929	94,402.07

On the day after Earle received the first of these three instalments, it paid the first sum, $41,055.00, to Raymond. No part of Estimates 8 and 9 was paid to Raymond, directly or indirectly. Estimate #10 for $42,662.25 was paid by the State directly to Raymond on July 9th, 1929.

Raymond never received its final instalment of $30,703.68.

On July 22nd, 1929 an involuntary petition in bankruptcy was filed against Earle in the United States District Court for the Eastern District of New York. Earle's receivers were appointed, qualified, acted and gave notice to the State thereof. The State, after suspending and cancelling the contract, completed the work through its own engineers. On April 9th, 1930, the State issued its order that it had completed the Earle contract, certifying that $279,942.76 was available to the credit of the contract subject to liens filed.

In the interim, on December 18th, 1929, the claimant was elected Earle's trustee in bankruptcy; he qualified and is still acting in such capacity.

Meanwhile, on March 18th, 1930, Raymond filed in the Court of Claims of the State of New York, its claim against

the State for the third instalment of $30,703.68 with interest. That case was tried on April 7th, 1930 but neither Earle, its receiver nor its trustee (the petitioner herein) was at any time a party to the action, none of them having been brought into the suit and none having appeared therein.

On May 29th, 1930, the Court of Claims entered its decision in the Raymond case (Claimant's Exhibit 15, p. 50) in favor of Raymond, finding that the State had disregarded Raymond's assignment when there were sufficient moneys in the hands of the Comptroller to pay Raymond out of Estimates #7, #8 and #9 of the Earle contract. It was concluded that after the assignment, Raymond had been entitled to be paid by the State Comptroller out of the succeeding three estimates of sums due to Earle in the amounts specified in the assignment, and that Raymond had not been paid its final instalment of $30,703.68 due from the State. Raymond's judgment for $30,703.68 with interest from June 17th, 1929 was entered on June 3rd, 1930.

On *June 9th, 1930*, the judgment with interest aggregating $32,506.73 was paid to Raymond by the State which purchased the judgment as an investment by the Comptroller for the Common School Fund (Claimant's Exhibit 16, p. 59). At the same time the State took an assignment of the Raymond judgment for the Common School Fund and thereafter held it as a part of the investment of said trust funds until the State Legislature of 1931 (the following year) made an appropriation for the payment of judgments of the Court of Claims. Thereafter, on *March 16th, 1931*, over nine months later, the State's Common School Fund was reimbursed for the payment of the Raymond judgment with interest, out of the appropriation made by the 1931 Legislature for judgments of the Court of Claims. Obviously, this reimbursement balanced the School Fund's investment of June 9th, 1930.

Nevertheless, the State asserted that as of June 12th, *1930* there had been available for the Earle contract only $247,436.03, arrived at by withdrawing said $32,506.73 (Raymond's judgment against the State, $30,703.68 plus interest

of $1,803.05) from the $279,942.76 certified as available on April 9th, 1930.

In item #12 of its claim, the petitioner sought to recover the $32,506.73 off-set by the State against the balance due to Earle's trustee in bankruptcy (the petitioner). The Court of Claims and the Appellate Division refused to grant the petitioner either the principal or interest portions of this item. The Court of Appeals on its modification, awarded the petitioner only the interest item of $1,803.05 which had been deducted from the balance to the credit of the Earle contract. Your petitioner still claims to be entitled to recover the principal item of $30,703.68.

B.

JURISDICTION.

(a) The statutory provisions believed to sustain the jurisdiction of this cause are 28 U. S. C. §344 (b) [Judicial Code, Sec. 237(b)] and 28 U. S. C. Secs. 861(a) and 861(b), the Act of January 31st, 1928, all as amended and re-enacted.

(b) The statute of the United States which is involved is 11 U. S. C. §108 (Sec. 68 of the Bankruptcy Act), prior to its amendment, June 22nd, 1938, c. 575, §1, 52 Stat. 878, reading as follows:

> "(a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.
>
> (b) A set-off or counterclaim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate; or (2) was purchased by or transferred to him after the filing of the petition, or within four months before such filing, with a view to such use and with knowledge or notice that such bankrupt was insolvent, or had committed an act of bankruptcy."

(c) The judgment to be reviewed (p. 82) was dated and entered on August 26th, 1940 in the Court of Claims of the State of New York, the Court of original jurisdiction, on the remittitur of the Court of Appeals of the State of New York, the highest Court of that State (p. 81). On October 8th, 1940, said Court of Appeals entered its order denying the petitioner's motion (timely made) for reargument of the appeal in said Court (p. 84). There is no further review possible except by this Court. This petition and the accompanying brief will be presented on or before January 7th, 1941, within three months of the date of the last mentioned order.

> *National Labor Relations Board* v. *Mackay*, 304 U. S. 333, 58 S. Ct. 904, 82 L. Ed. 1381.

(d) Cases which sustain the jurisdiction of this Court to pass on the right and title of a trustee in bankruptcy to recover an asset, involving the provisions of the Bankruptcy Act and thereby presenting a proper Federal question for review by this Court, are:

> *Williams* v. *Heard*, 140 U. S. 529, 11 S. Ct. 885, 35 L. Ed. 550;
> *Rector* v. *City Deposit Bank Company*, 200 U. S. 405, 26 S. Ct. 289, 50 L. Ed. 527.

In the *Rector* case, the respondent contended that there was no Federal question involved and, if there were, there was no right of review. Mr. Justice White said, at page 411:

> "Both these contentions might well be disposed of by saying that the action was brought by a trustee appointed under the bankrupt law of the United States, seeking to recover what was asserted to be an asset of the bankrupt estate under that law. This, therefore, presented a Federal question and the denial of the asserted right was a denial of a right or title specially claimed under a law of the United States. *Peck* v. *Jenness*, 7 How. 612; *Barton* v. *Geiler*, 108 U. S. 161; *Williams* v. *Heard*, 140 U. S. 529; *Dushane* v. *Beall*, 161 U. S. 513; *Stanley* v. *Schwalby*, 162 U. S. 255."

(e) The Federal question involved was raised throughout the entire proceeding. In the petitioner's Notice Of Intention To File A Claim (p. 8, *et seq.*) and the petitioner's Claim (p. 3, *et seq.*) the bankruptcy adjudication, the appointment and respective qualifications of the receivers and trustee in bankruptcy, and the State's diversion of the balance due to the petitioner without lawful right or authority, causing a depletion of the assets of the bankrupt estate, were specifically pleaded. In the petitioner's Requests to Find (p. 32, *et seq.*), the jurisdictional features of the claim were repeated. They are similarly set forth in the formal Decision of the Court of Claims (p. 13, *et seq.*).

The Federal question was argued by both sides in their briefs for the Appellate Division; in fact, the respondent printed the statute involved, 11 U. S. C. 108 (Sec. 68 of the Bankruptcy Act), in its entirety at page 6 of its brief. In the briefs for the Court of Appeals, said section was printed at page 11 of the petitioner's brief and at page 6 of the respondent's brief. The opinions of the two Courts below refer to the argument concerning the applicability of the quoted section of the Bankruptcy Act. Hill, *P. J.*, for the Appellate Division, did not agree with the petitioner (p. 71, fol. 212). Sears, *J.*, for the Court of Appeals, similarly held that the bankruptcy of Earle did not affect the State's right to take the disputed set-off (p. 79, fol. 79). It is this failure or refusal of the Court below to recognize and hold (although there is no precise decision by this Court on the point) that under the circumstances at bar, the State was not entitled to any set-off under a proper interpretation of the quoted section of the Bankruptcy Act, which warrants this application.

C.

The Questions Presented.

1. After the bankruptcy of Earle and intervention of the rights of its creditors, did the State have the right to set-off against the contract balance due to Earle's trustee (the peti-

tioner), the amount which the State paid for Raymond's judgment against the State, recovered as a result of the State's negligence?

2. Did the assignment from Earle to Raymond cover only the three specified instalments so that the State could not justify paying Raymond out of the Earle contract balance after those instalments have been paid and Earle's bankruptcy occurred?

D.

Reasons Relied On for Allowance of the Writ.

The Court is respectfully referred to the Argument set forth in the accompanying Brief for the petitioner's reasons relied on for allowance of the writ. It is earnestly maintained that the State Court has decided a federal question of substance not theretofore determined by this Court, or has decided it in a way probably not in accord with applicable decisions of this Court. (Rule XXXVIII, paragraph 5(a), of the Rules of this Court.)

This Court is urged to exercise its discretion in favor of the application, to finally determine legal questions of national importance, as is manifested by the interest displayed by members of the Bar in the opinion of the Court of Appeals in this case.

Wherefore, your petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this Honorable Court directed to the Court of Claims of the State of New York and the Court of Appeals of the State of New York, commanding said Courts to certify and to send to this Court for its review and determination, a full and complete transcript of the record and all proceedings in said Courts had in the action entitled, *"William H. Kniffin, as trustee in bankruptcy of C. H. Earle, Inc., bankrupt, claimant, against State of New York,"* to the end that said case may be re-

viewed and determined by this Court as provided by the statutes of the United States, and that said judgment be reversed by this Court and that your petitioner may have such other and further relief in the premises as to this Court may seem just and proper.

Dated, January 2nd, 1941.

WILLIAM H. KNIFFIN,
as trustee in bankruptcy of
C. H. Earle, Inc., bankrupt.

By: LLOYD B. KANTER,
Counsel for petitioner.

SIDNEY SQUIRE,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1940.

No. .

WILLIAM H. KNIFFIN, as trustee in bankruptcy of C. H. EARLE, INC., Bankrupt,

Petitioner,

—against—

STATE OF NEW YORK,

Respondent.

BRIEF IN SUPPORT OF PETITION.

I.

Opinions of the Courts Below.

No opinion was rendered in the Court of Claims of the State of New York. In the Appellate Division, Third Department of that State, Hill, *P. J.*, wrote for the unanimous Court, reported in 257 App. Div. 43, 12 N. Y. Supp. (2nd) 422 (p. 70).

For the Court of Appeals of that State, Sears, *J.*, wrote for the unanimous Court, reported in 283 N. Y. 317 (p. 76). No opinion was rendered on the denial of the petitioner's motion for reargument (p. 84), in that Court, reported in 284 N. Y. —— (page not yet officially assigned).

II.

Jurisdiction.

The grounds on which the jurisdiction of this Court is invoked, are set forth in the accompanying petition, to which reference is hereby made as though fully set forth herein. It is, therefore, not repeated.

III.

Statement of the Case.

The attention of the Court is respectfully directed to the petition herein which contains a general outline of the facts and is to be deemed repeated herein, although not reprinted, except as amplified in the argument.

IV.

Assignment of Errors.

The Court of Appeals of the State of New York erred:

(1) In failing to determine that the respondent had no right of off-set pursuant to Section 68 of the Bankruptcy Act (11 U. S. C. 108).

(2) In its construction that the Earle assignment to Raymond covered the Earle contract balance or any instalment other than the three instalments specifically recited in the instrument of assignment.

V.

Argument.

Point A.

After the bankruptcy of Earle and the intervention of the rights of its creditors, the State had no right to set-off against the contract balance due to Earle's trustee (the petitioner), the amount which the State paid for Raymond's judgment against the State, recovered as a result of the State's negligence.

Point B.

The assignment from Earle to Raymond covered only the three specified instalments so that the State could not justify paying Raymond out of the Earle contract balance after

those instalments had been paid and Earle's bankruptcy occurred.

POINT A.

After the bankruptcy of Earle and the intervention of the rights of its creditors, the State had no right to set-off against the contract balance due to Earle's trustee (the petitioner), the amount which the State paid for Raymond's judgment against the State, recovered as a result of the State's negligence.

The State Courts have failed to recognize the effect of Earle's bankruptcy and the rights of general creditors in the bankrupt's assets.

On July 22nd, 1929 when an involuntary petition in bankruptcy was filed against Earle (p. 48, fol. 142), the contractor had as its principal asset the large contract with the State of New York for the construction of part of Jones Beach Causeway. This job was not yet finished. After the bankruptcy, the State elected to complete the work through its own engineers. All general creditors of the bankruptcy-contractor had the right to depend upon the credit balance which would be found due to the bankrupt-contractor when the job was finished.

After the completion of the job, the State on April 9th, 1930 issued its certificate that $279,942.76 was available to the credit of the contract (p. 48, fol. 144).

The petitioner, Earle's trustee, had reason to believe that he would receive said sum, subject only to *applicable* liens and assignments. However, when the time came for the State to make payment, it insisted that there was only $247,426.63 available. The difference of $32,506.73 which had been deducted (wrongfully, according to the petitioner) was the amount of Raymond's judgment against the State, $30,703.68 and interest. The interest has been awarded to this petitioner by the Court of Appeals. Sears, *J.*, writing for that Court, in the next to the last paragraph of the opinion (at p. 80), said:

> "* * * As to the interest, however, there should be a modification. The State had in its hands, as found by the Court of Claims, funds sufficient to pay the Raymond account against the Earle Company before the Earle bankruptcy. It did not do so. As the delay in payment of the Raymond claim was due solely to the State's disregard of the terms of the assignment, no interest should be allowed thereon in favor of the State."

It seems strange, indeed, for that Court to have reached such conclusion with respect to the interest but not as to the principal, even though that, too, had not been paid to Raymond "due solely to the State's disregard of the terms of the assignment".

Throughout this proceeding the petitioner emphasized that although the respondent claimed, among other things, that it had made the deduction by virtue of the set-off permitted by Section 68 of the Bankruptcy Act, 11 U. S. C. § 108, the fact is that the source of the payment on June 9th, 1930 of Raymond's judgment was *not* the Earle contract balance but the purchase of an investment by the Comptroller for the Common School Fund (Claimant's Exhibit 16, at fol. 177). There is no dispute about that fact. It is contained in the Agreed Statement of Facts In Lieu of Testimony at page 49, folio 146.

Not until nine months thereafter, in March 1931, was the Common School Fund reimbursed for the payment of that judgment. The assignment of the Raymond judgment which the State's Common School Fund had taken on June 9th, 1930, was thus satisfied. Everyone agrees on that and it is so set forth in the opinion of Sears, *J.*, page 79. The reimbursement was made "from the appropriation made by the Legislature for judgments of the Court of Claims" (Claimant's Exhibit 16, p. 59, at fol. 177). The State's contrary assertion that in the intervening period it deducted the amount of the Raymond judgment and interest from the Earle balance, is a mathematical inconsistency, patently a belated after-thought. Earle's creditors were legally dam-

aged by this bookkeeping juggling because the contract credit balance was thus diminished.

It is respectfully urged that this Court should exercise its discretion by granting this application so that the error committed by the highest Court of said State can be corrected. Unfortunately, legal reasoning has been sadly obscured by that portion of the opinion of Sears, *J.* (p. 80), which states:

> "We find no significance in the facts relating to the manner of the payment of the Raymond judgment by the State. Whatever bookkeeping entries were made by the State, whatever practice was pursued to secure the money from State funds, the essence of the transaction is that the State paid the judgment when it paid Raymond, at least so far as the plaintiff is concerned. Even if we regard the transaction when the judgment was assigned by Raymond to the State for the Common School Fund as keeping the judgment unsatisfied and outstanding, it was afterwards paid and satisfied."

That is a model of inconsistency and contradiction. How can the State maintain at one and the same time that the Raymond judgment was unsatisfied by the assignment given to the Common School Fund (which held it for nine months) and yet previously satisfied by the deduction from the Earle contract balance?

In the Court of Claims proceeding instituted by Raymond against the State after the bankruptcy (Decision, p. 22, at fol. 65, findings #38, 39, 40 and 41), the State made no move to bring the bankrupt, its receivers or trustee into the suit (Agreed Statement of Facts In Lieu of Testimony, p. 48, fol. 144). This it could and should have done under former Section 20 of the Court of Claims Act (now Sec. 9, paragraph 5), which then read:

> "INTERPLEADER, CONSOLIDATION AND NEW PARTIES. Jurisdiction and powers are conferred upon the court of claims or a judge thereof to order other parties, known or unknown, to be brought in and made parties to any action or proceeding pending in such court,

> or substituted, whenever it appears or is made to appear to the court or a judge thereof necessary for a complete determination of a controversy or liability; * * * to consolidate claims or actions and to order interpleader, in the same manner and to like extent and with like effect in matters over which such court of claims have, or shall have, jurisdiction, as is conferred upon other courts by sections eighty-three, ninety-six, one hundred and ninety-three and two hundred and eighty-seven of the civil practice act, and section forty-eight of the surrogate's Court act."

Raymond pleaded a cause of action against the State only. Raymond did not seek to fasten its assignment or alleged lien against any contract balance due to Earle. Raymond took no part in the bankruptcy proceeding. It proceeded against the State in the Court of Claims which granted judgment against the State because of the latter's failure to comply with the terms of the filed assignment. (Decision of the Court of Claims in that case, Claimant's Exhibit 15, pp. 50, *et seq.*) The State had determined to litigate that issue by itself. It is bound by that judgment.

When the State made the criticized deduction, Earle's bankrupt estate was being administered by this petitioner. The State's right to a set-off had to be justified under Section 68 of the Bankruptcy Act, 11 U. S. C. 108. It was made almost a year after the bankruptcy without the approval of any Court, Federal or State. The claim at bar was filed to compel the State to submit to a Court its justification for the deduction.

At page 248 of Volume 4, Remington on Bankruptcy (4th Edition, 1935), states:

> "Sec. 1472. COURT ACTION TO MAKE OFF-SET AVAILABLE: The right of set-off can be exercised by the parties before the bankruptcy; but, after the bankruptcy, set-off is under the control of the court, and is not automatic but required action on the part of the parties interested to make it available.
>
> Sec. 68 (a) U. S. Code, title 11, Section 108 is not self-executing. It contemplates judicial action, for it

> provides that the account shall be stated, offset be made and the balance only allowed."

To the same effect is Collier on Bankruptcy, 13th Edition, Volume 2, page 1603.

The following is quoted from *Cumberland Glass Co.* v. *DeWitt*, 237 U. S. 447, 59 L. Ed. 1042, 35 Sup. Ct. 636, 34 A. B. R. 723:

At page 455:

> "The language of the act indicates the necessity of action by the court, for the statute provides that 'the account shall be stated', and the one debt set off against the other, and the balance only allowed to be paid. This statute recognizes the nature of set-off, as established in common law and equitable procedure. * * *"

At page 456:

> "If it (the State) had the right to do so, it did not seek the action of the bankruptcy court to state the account or make the settlement, and we have been unable to find any case, and none is called to our attention, in which it is held that simply because of the bankruptcy proceedings and the filing of the schedule and proofs of debts the set-off is automatically made between parties holding mutual credits. On the other hand, as the act indicates and so far as we know, all the authorities hold this section is not self-executing, but its benefit is to be had upon the action of the district court only when it is properly invoked, and that court has the primary duty of determining for itself whether there are 'mutual debts or credits' that should be set off one against the other according to the true intent and meaning of the Bankruptcy Act." *

---

* (We do not contend that only the Federal Court has the right to pass upon a set-off. Apparently, that can also be determined in the State Court to which jurisdiction is granted by the conflicting parties. *Smith* v. *Hale*, 56 S. D. 12, 227 N. W. 373, 17 Am. B. R. (N. S.) 104. In *re Petrich*, 43 Fed. (2nd) 435. 16 Am. B. R. (N. S.) 547.)

In this case, the respondent had *the burden of proof* to sustain its action in exercising the set-off. Remington, in Vol. 4, page 244, Section 1466, says:

> "BURDEN OF PROOF OF PROPRIETY OF OFF-SET. The burden of proof is on the debtor seeking to use the off-set to show it was received before the bankruptcy and without knowledge of the impending bankruptcy."
>
> *In Re*: *Shults*, 135 Fed. 623, 14 Am. B. R. 378;
> *Lowden* v. *Northwestern National Bank & Trust Company*, 84 Fed. (2nd) 847, 31 Am. B. R. 655.

The State cannot sustain that burden because it has not come within the prerequisites of the cited section of the Bankruptcy Act. Sub-division "a" thereof requires that the debts or credits be *mutual* between the estate of a bankrupt and a creditor. That is not the situation here. The State did not set-off its own claim against the contract balance. What the State did was to arrogate unto itself the right to recoup a judgment paid to its own judgment-creditor, not the bankrupt nor the petitioner. The judgment was based on its own negligence in failing to comply with the filed assignment.

In construing the cited section, Mr. Justice Butler wrote for this Court, at page 248, in

> *McCollum* v. *Hamilton National Bank of Chattanooga, Tenn.*, 303 U. S. 245, 58 S. Ct. 568:
>
> "The words 'debts' and 'credits' as there used are correlative. What is a debt on one side is a credit on the other. *Libby* v. *Hopkins*, 104 U. S. 303, 309."

That is not the situation here.

Moreover, Collier's on Bankruptcy, Vol. 2, page 1610, and Remington on Bankruptcy, Vol. 4, page 220, both repeat that the mutual demands must have existed *before* the filing of the bankruptcy petition and that each debt must be owed to the other party.

That is not the situation at bar. The State never claimed any set-off nor did it do anything in that direction until after it paid the Raymond judgment long after the bankruptcy.

The State knew that the fund in its possession belonged to other assignees, lienors and the trustee acting for general creditors of the bankrupt. The third payment due to Raymond was no longer in existence. The State had paid the judgment for its own neglect. It could not make itself a priority creditor of the bankrupt by subsequently deducting from the bankrupt's estate, Raymond's judgment with interest. This was more than Raymond could have obtained from the estate. At the time of the bankruptcy, Raymond was only a general creditor like the others. This third instalment which had been paid to the bankrupt was not in existence, could not be identified, could not be traced and there was no other similar or even lesser amount in the bankrupt's bank account at its bankruptcy. It was consequently neither a priority creditor nor a *cestui que* of any trust.

> *National City Bank* v. *Hotchkiss*, 231 U. S. 50, 34 S. Ct. 20, 58 L. Ed. 115.

Even adopting the State's argument, the best that it could accomplish would have been to step into the shoes of Raymond. Raymond's status was that of an unsecured general creditor but the State gave itself a priority, thus getting a new pair of shoes. In the bankruptcy proceeding, Raymond would have received the same dividends as all other general creditors. The State "grabbed" 100% plus interest.*

If the State really had the right to use the contract fund for such payment, why did it (a) refuse to pay Raymond's claim, (b) defend the Court of Claims action, (c) pay Raymond's judgment with interest, by resorting to the Common School Fund, (d) take an assignment of the Raymond judgment, and (e) subsequently reimburse that fund out of the 1931 appropriation for judgments of the Court of Claims? It must be concluded that the judgment of Raymond against

---

* (Should this Court grant certiorari and, after argument, modify the judgment below, the State will be able to file its claim in the Earle bankruptcy proceeding [§57(n) of the Bankruptcy Act, 11 U. S. C. §93(n)], receive the dividends heretofore paid to all other creditors and participate rateably with them in the proceeds of the judgment at bar.)

the State was not the "mutual" debt of the State against the bankrupt estate.

Sub-division "b" of Section 68 declares that the set-off shall not be allowed if it "was purchased by or transferred to" the creditor (the State) after the filing of the petition or in certain instances within the preferential four months' period prior to the filing of the petition. (The portion of the section is significantly written in the negative.) The State failed to show that it did not come within the prohibited periods.

The purpose of the section is to prevent one creditor from obtaining advantage over the others.

> *Cumberland Glass Co.* v. *DeWitt,* 237 U. S. 447, 35 S. Ct. 636, 59 L. Ed. 1042, 34 Am. B. R. 723;
> *Continental & Commercial T. & S. Bank* v. *Chicago T. & T. Co.,* 229 U. S. 435, 33 S. Ct. 829, 57 L. Ed. 1268, 30 Am. B. R. 624;
> *Merchants National Bank,* v. *Sexton,* 228 U. S. 634, 33 S. Ct. 725, 57 L. Ed. 998, 30 Am. B. R. 278.

In the last cited case, Chief Justice White wrote, at page 643:

> "By the effect of the bankruptcy the rights of the parties became fixed. * * * It was in the power of neither class to set aside or frustrate as against the other the rights fixed by the adjudication and which it was the duty of the trustee to conserve and administer."

More recently, this Court in another situation, in which Section 68 was not involved, ruled that a claim obtained after bankruptcy was not entitled to priority.

> *U. S.* v. *Marxen* (*In re Monterey Brewing Co.*), 307 U. S. 200, 59 Sup. Ct. 811, 83 L. Ed. 1222.

There, the trustee in bankruptcy pointed out that the original creditor, the bank, had not presented or proved a claim in the bankruptcy court but assigned its claim to the government *after* the bankruptcy.

Mr. Justice Reed, writing for the unanimous Court (Chief Justice Hughes and Mr. Justice Douglas taking no part), said, at page 205:

> "* * * The statement of the case and the question certified show that the claim in bankruptcy of the Government is based upon the note, duly assigned to it after bankruptcy."

At page 207, the opinion continued:

> "We are of the view that Section 3466 is inapplicable to general claims in bankruptcy transferred to the United States or to which it has become subrogated on payment, after the filing of the petition, for the reason that the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy. This is true both as to the bankrupt and among themselves. (Citations.) The assets at that time are segregated for the benefit of the creditors. (Citations.)"

The reasoning there employed applies with equal force to the situation at bar. Here, the State's right to a set-off, if any, did not arise until after the State paid the Court of Claims' judgment obtained by Raymond. That was long *after* the filing of the bankruptcy petition. Hence, subdivision "b" of Section 68 makes illegal the attempted set-off.

In view of all of the foregoing, it is apparent that the State Courts did not appreciate the applicability of the cited section and cases to the situation at bar. It is respectfully submitted that the determination of this national question is a proper subject for review by this Court warranting the exercise of discretion in favor of the granting of this application.

POINT B.

The assignment from Earle to Raymond covered only the three specified instalments so that the State could not justify paying Raymond out of the Earle contract balance after those instalments had been paid and Earle's bankruptcy occurred.

It is believed that the preceding point is of sufficient importance in and of itself to warrant certiorari. However, for

the sake of completeness and especially in view of the interest which the case at bar has engendered, this point must be urged as a vital reason for the granting of the application.

At no time during the proceeding, did either of the parties maintain that the assignment to Raymond covered any more than the three specific payments due to Earle after the said assignment. In the respondent's brief to the Court of Appeals, the Attorney General (at p. 3) stated that

> "the assignment provided that the instalments should be paid out of the three succeeding payments due to the contractor from the State."

Indeed, this had been stipulated by both counsel in the Agreed Statement of Facts in Lieu of Testimony, page 45, folios 135, *et seq.*

The source of that stipulation was the formal Decision at bar (p. 17, fols. 51, *et seq.*) which had been prepared and submitted by the Attorney General. These were taken from Claimant's Exhibit 15, the formal Decision of the Court of Claims in the case of Raymond against the State, where the body of the assignment was recited *verbatim* in Finding of Fact #10, page 53, folios 158, *et seq.* Despite all this, the Court of Appeals stated that the assignment (p. 79)

> "provided for its payment out of three subsequent estimates, but did not confine its assignment to said estimates. In other words, the assignment covered subsequent installments which might fall due under Earle's contract with the State in case the full amount had not already been paid to Raymond, no matter what was the reason for this situation resulting."

This is amazing in the light of the fact that Sears, *J.*, in the opening of the opinion (p. 76) quotes *verbatim* from the body of the assignment. There is no ambiguity in the instrument. Its clarity was never questioned.

The claimed justification for this conclusion is stated by the Judge to be (p. 79) that

> "The record does not contain the full text of the assignment from the Earle Company to the Raymond Company, which furnishes the basis of the State's position."

The fact is (as was thereafter demonstrated to the Court and not disputed by the respondent) that there is nothing else in the assignment but one paragraph of prefatory recitals and two closing paragraphs consisting of the usual power of attorney and witness clause. The case should have been decided on what was before the Court.

It is apparent that the Court of Appeals believed that the earlier determination of the Appellate Division could not be sustained on any other basis of fact. Certainly the Appellate Division did not dispute that the assignment meant what both counsel said it meant: "the three succeeding payments". Nevertheless, the Court of Appeals, as an expedient found it necessary for the support of its decision, to say that its construction was different.

The answer must be that the Court of Appeals realized that in no other way could it sustain judgment for the respondent on that issue. Thus, only could it say, "In this aspect, the bankruptcy of Earle is unimportant" (p. 79). With that vital legal question out of the way, the opinion then cited the only case mentioned therein, *Riverside Contracting Co.* v. *City of New York*, 218 N. Y. 596 (Rec., p. 80). But that case is not adequate support for the position taken because it did not deal with assigned moneys which had been paid out *before* the bankruptcy, as at bar. Nor was there involved a suit litigated only by parties in the respective positions of Raymond and the State, a judgment for Raymond because of the State's failure to comply with the assignment and the subsequent maneuvers of the State whereby the judgment was assigned and then paid.

The entire opinion of Sears, *J.*, is in the subjunctive mode, *viz.*: "If then, the assignment was not confined to the particularly specified payments * * *" (p. 79); and, "If our construction of the assignment is correct * * *" (p. 80). This is so far from the fact that we are compelled to urge it as a basis for review to prevent any re-occurrence in future litigation. Such an attitude deserves the attention of this Court on the merits.

It is recognized that this Court does not usually grant certiorari to review evidence and to discuss specific facts. However, on previous occasions this Court has not hesitated to declare an exception to the rule and to grant review where warranted. There is ample precedent for such reversal of a State Court. In

Interstate Amusement Co. v. *Albert,* 239 U. S. 560, 36 S. Ct. 168, 60 L. Ed. 439,

Mr. Justice Pitney wrote, at page 566:

> "But this rule has its exceptions, as, for instance, where there is ground for the insistence that a Federal right has been denied as the result of a finding that is without support in the evidence. *Southern Pacific Co.* v. *Schuyler,* 227 U. S. 601, 611; *North Carolina R. R.* v. *Zachary,* 232 U. S. 248, 259; *Carlson* v. *Washington,* 234 U. S. 103, 106."

So, too, Mr. Justice Sanford, in

Fiske v. *State of Kansas,* 274 U. S. 380, 47 S. Ct. 29, 63 L. Ed. 129,

reiterated, at page 385,

> "And this Court will review the findings of facts by a State Court where a federal right has been denied as the result of a finding shown by the record to be without evidence to support it; * * *."

More recently, in

United Gas Public Service Co. v. *State of Texas,* 303 U. S. 123, 58 S. Ct. 438, 82 L. Ed. 702,

at page 143, Chief Justice Hughes declared:

> "We make that analysis, not to determine issues of fact arising on conflicting testimony or inferences, and thus to usurp the function of the State Court as a trier of the facts, but to perform our own proper function in deciding the question of law arising upon the findings which the evidence permits. *Kansas City Southern Ry. Co.* v. *Albers Commission Co.,* 223 U. S. 573, 591."

Here, the State Court denied a federal right (under the Bankruptcy Act) to the petitioner by "finding" facts in an unambiguous assignment without evidence to support such finding. Raymond never claimed the assignment was effective for any payment beyond the third payment; nor did the State. Only the Court of Appeals did. It remains for this Court to clarify the legal situation.

Conclusion.

It is respectfully submitted, therefore, that this case is one which requires the granting of a writ of certiorari to the end that the errors committed by the State Courts in the decision of a federal question may be corrected.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 685

WILLIAM H. KNIFFIN, as Trustee in Bankruptcy of C. H. EARLE, INC., Bankrupt,

Petitioner,

against

THE STATE OF NEW YORK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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against

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Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

May it Please the Court:

Now comes the respondent in the above entitled cause, by its counsel of record, and opposes the petition herein, and asks that same be denied.

Statement of the Case.

This action arises out of a contract entered into between the State of New York and C. H. Earle, Inc., on or about the 3rd day of August, 1928, for the improvement of Jones Beach Causeway in the County of Nassau, in the State of New York. In July, 1929, C. H. Earle, Inc., filed a voluntary petition of bankruptcy. William H. Kniffin and J. Russell Sprague

were duly appointed Receivers by the District Court of the United States for the Eastern District of New York. In November, 1939, C. H. Earle, Inc., was adjudicated a bankrupt and, thereafter, William H. Kniffin was elected and appointed Trustee.

The said Trustee thereafter, and on January 21st, 1931, pursuant to Notice of Intention to File Claim filed on October 8th, 1930, duly filed its claim in the Court of Claims of the State of New York. The claim was subsequently tried in that Court; an appeal taken to the Appellate Division of the Supreme Court, Third Judicial Department; and thence went to the Court of Appeals of the State of New York on Item #12 of the claim alone. The opinion of that Court is reported in 283 N. Y. 317.

Item #12 of the Claim reads as follows:

> "On the 9th day of June, 1930, the State of New York, without lawful right or authority, diverted from the moneys on hand applicable to the payments under said contract the sum of $32,516.73 and paid the same to the Raymond Concrete Pile Company in satisfaction of a judgment of the Court of Claims of the State of New York against the State, and thereby depleted the moneys that should be on hand payable under said contract, for which sum, with interest thereon from the date of its said diversion, the claimant is entitled to an award" (fols. 19-20).

The amount demanded under said Item #12 was $32,506.73, consisting of $30,703.68 principal and $1,803.05 interest. The Court of Appeals modified the judgment by awarding to petitioner the interest item of $1,803.05. Only the principal of $30,703.68, under said Item #12, is here involved.

ARGUMENT.

The determination of the state courts was proper and the petition should be denied.

Petitioner's contention here is that the State diverted the sum of $32,516.73 (because of the allowance of the interest item by the Court of Appeals the sum involved is now $30,703.68), applicable to payments under this contract by the payment of that sum to the Raymond Concrete Pile Company in satisfaction of a judgment in that amount rendered against the State of New York by the Court of Claims.

The Raymond Concrete Pile Company, as a subcontractor for C. H. Earle, Inc., performed a part of the work and furnished part of the labor required by the contract herein of the value of $102,426.36. On the 17th day of May, 1929, C. H. Earle, Inc., assigned to the Raymond Concrete Pile Company out of moneys due or to become due from the State of New York, said sum of $102,426.36 to be paid in three installments, to wit: $41,055.00, $30,703.68 and $30,703.68. The assignment provided that the installments should be paid out of the three succeeding payments due to the contractor from the State. By reason of these assignments there was paid to the Raymond Concrete Pile Company on May 22, 1929, the sum of $41,055, and on July 9, 1929, the sum of $30,703.68. The last amount named in the assignment, the same being the second item of $30,703.68, was not paid to the assignee, but it was paid to C. H. Earle, Inc., and that concern retained and used this money.

Thereafter, the assignee, the Raymond Concrete Pile Company, filed a claim against the State of New

York and recovered the said sum of $30,703.68, with interest thereon from June 17, 1929. At the time this claim was instituted by the assignee, the petition in bankruptcy had been filed. The judgment in favor of the assignee was entered in the office of the Clerk of the Court of Claims on June 3, 1930. This judgment was paid by the respondent on July 9, 1930, the whole amount thereof, including interest, totaling $32,516.73.

At the time of the completion and acceptance of this contract on April 9, 1930, the respondent had on hand and allocated to payments for work done under this contract the sum of $279,942.76. Due to the fact that there were no moneys remaining in the fund for the payment of Court of Claims judgments at the time the judgment of Raymond Concrete Pile Company was entered, the Department of Audit and Control of the State of New York paid the judgment from funds in its hands as trustee, viz., the Common School Fund, and the judgment was assigned to the Comptroller of the State of New York as trustee for that fund. Thereafter, when moneys became available, the Common School Fund was repaid from the fund appropriated for payment of Court of Claims judgments and subsequently the fund for the payment of Court of Claims judgments was reimbursed from the moneys in the hands of the Comptroller and allocated to payments for work done under the contract in question here.

Petitioner's contention is that because of the bankruptcy of the contractor the funds in the hands of the Comptroller became, subject to existing valid assignments and liens, the property of the Trustee

in Bankruptcy for the benefit of all creditors of the contractor, and that the respondent was in error in crediting the amount of the judgment of the Raymond Concrete Pile Company against this fund. Petitioner alleges that by its actions the respondent made itself a preferred creditor.

There is no question but that assignments of moneys to become due are enforceable in the State of New York. (See *Field v. Mayor of New York,* 6 N. Y. 179, *Hinkle Iron Company v. Kohn,* 229 N. Y. 179.) Neither can there be any doubt that a payment by a debtor to an assignor after notice does not discharge the obligation of the debtor to the assignee. (*Weniger v. 14th Street Store,* 191 N. Y. 423; *Prata v. Greene,* 70 App. Div. 224, affirmed 174 N. Y. 535; *Torey v. New Amsterdam Casualty Company,* 124 Misc. 361.)

How can it seriously be contended that the creditors of the bankrupt contractor have been deprived of any rights? A valid non-fraudulent assignment is superior to the claims of subsequent lienors or trustees in bankruptcy. (*Riverside Contracting Co. v. City of New York,* 218 N. Y. 596; *Post & McCord v. City of New York,* 86 Misc. 300.)

In 5 *Corpus Juris,* 966, 967, the following rule is set forth:

> "As against the assignor the assignee becomes the owner of the chose from the time of the assignment, subject to the qualifications heretofore stated. After that time the assignor loses all right of control over the same and will not be allowed to defeat the rights of the assignee, whether the assignment is good at law or only in equity. He has no right to collect or compromise the chose,

nor in any way to discharge the debtor therefrom, nor to modify the chose, as by an extension of time to the debtor. If thereafter the assignor does collect, the chose, the moneys in his hands arising therefrom will be held as trust funds belonging to the assignee, and so a judgment thereafter recovered by the assignor against the debtor will be for the use of the assignee."

See also:

Superior Brassiere Co. v. Zimetbaum, 214 App. Div. 525;

Hofferberth v. Duckett, 162 N. Y. Supp. 167.

The respondent contends that the petitioner, trustee in bankruptcy herein, has no right whatever which can or should be enforced as against the State. Had there been no mistake made and had the payment of $30,703.68 never been made to C. H. Earle, Inc., as heretofore stated, no controversy ever could have arisen. How can the trustee be in any better position simply because the money was mistakenly paid and the respondent later reimbursed itself from moneys on hand due to the contractor? Even though some blame might attach to someone in the respondent's service for making the payment to C. H. Earle, Inc., in the face of the assignment to Raymond Concrete Pile Company, can it be said that C. H. Earle, Inc., is entirely free from blame herein? That concern received the money and presumably used it in its business while knowing that it had no title to the same. However, if it be found that some rights did accrue to the trustee in bankruptcy, can it not be said that the creditors of the bankrupt corporation have suffered no loss and this by reason of Section 108 of the Bankruptcy Act (United States Code Annotated, Title 11, P. 405), reading as follows:

"Section 108. (a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.

"(b) A set-off or counterclaim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate; or (2) was purchased by or transferred to him after the filing of the petition, or without four months before such filing, with a view to such use and with knowledge or notice that such bankrupt was insolvent, or had committed an act of bankruptcy. (July 1, 1898, c. 541, Section 68, 30 Stat. 565.)"

Scant attention should be paid to the fact that the judgment of the Raymond Concrete Pile Corporation was first paid by the respondent from funds held by the Comptroller of the State of New York as trustee, that the trust fund was later reimbursed from the fund appropriated for Court of Claims judgment, and that all this took place previous to charging the amount of the judgment back against the moneys in the hands of the respondent that were due on this particular contract. This procedure should have absolutely no bearing on the controversy for certainly the State of New York from the very day that it mistakenly paid the $30,703.68 to C. H. Earle, Inc., had an absolute right to reimburse itself from any and all funds in its hands due to C. H. Earle, Inc.

In substance the argument of the petitioner amounts to this: because the respondent has mistakenly paid to this claimant the sum of $30,703.68 to which it was not entitled and then reimbursed itself for the same, it should now again be compelled to pay an additional identical amount. Neither equity, justice, law nor reason supports any such position.

The trustee in bankruptcy and the petitioner herein in his capacity as a representative of the creditors of C. H. Earle, Inc., cannot reasonably contend that any harm has come to the creditors. The bankrupt corporation had the use and benefit of the $30,702.68 and indirectly, of course, all creditors received a similar benefit. We respectfully submit, therefore, that this cause presents no question sufficiently substantial to warrant review by this Court.

Opinions Below.

The opinion of the Court of Appeals of the State of New York is reported in 283 N. Y., at page 317. The decision of that Court modified, and as modified, affirmed the decision of the Appellate Division of the Supreme Court of the State of New York, Third Judicial Department, reported in 257 App. Div., at page 43. The petitioner's motion for reargument in the Court of Appeals of the State of New York was denied, as reported in 284 N. Y. 25 (Advance Sheet No. 79, dated November 2, 1940).

Dated: January 24, 1941.

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